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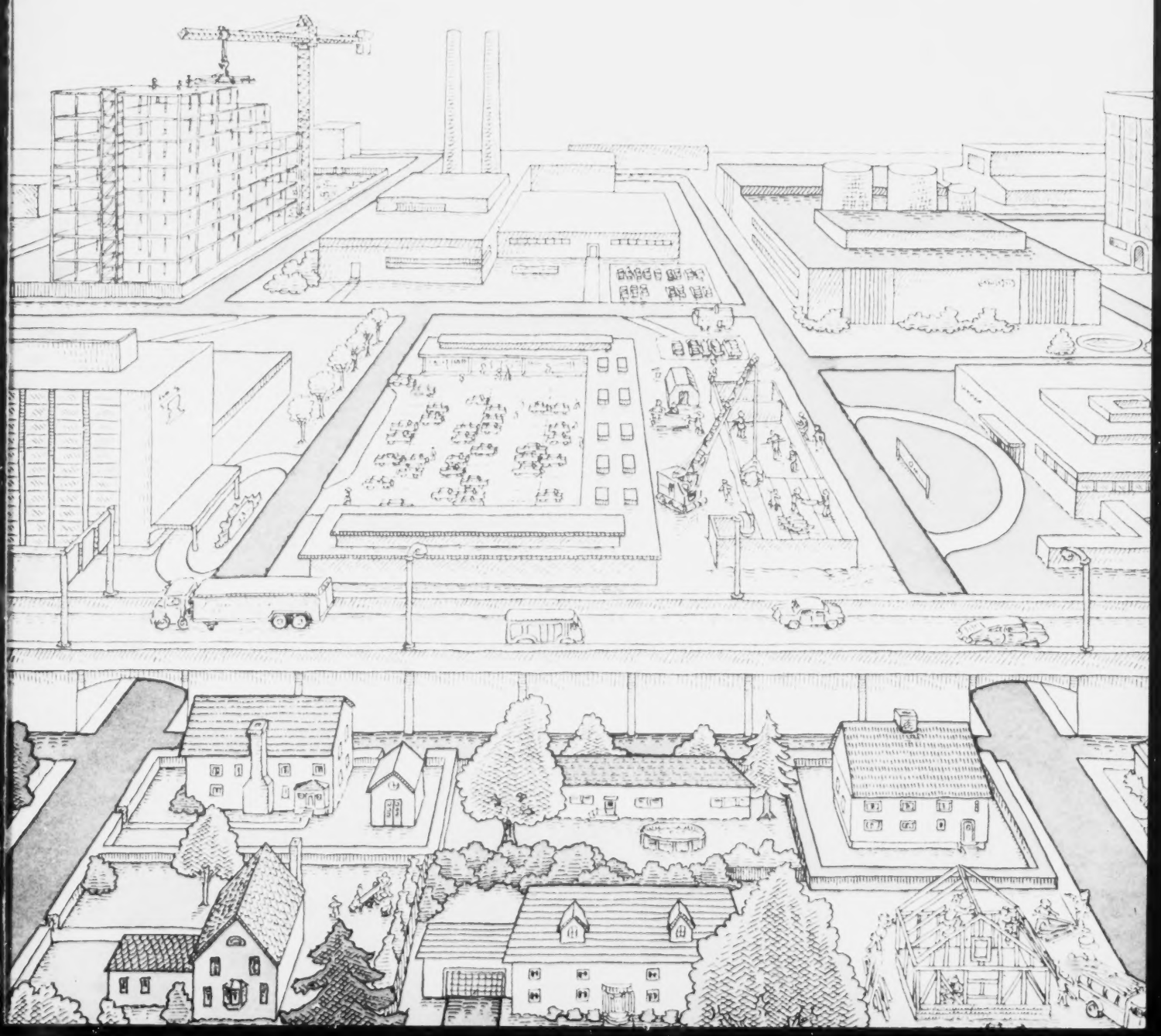
1984 Dodge/Sweet's Construction Outlook

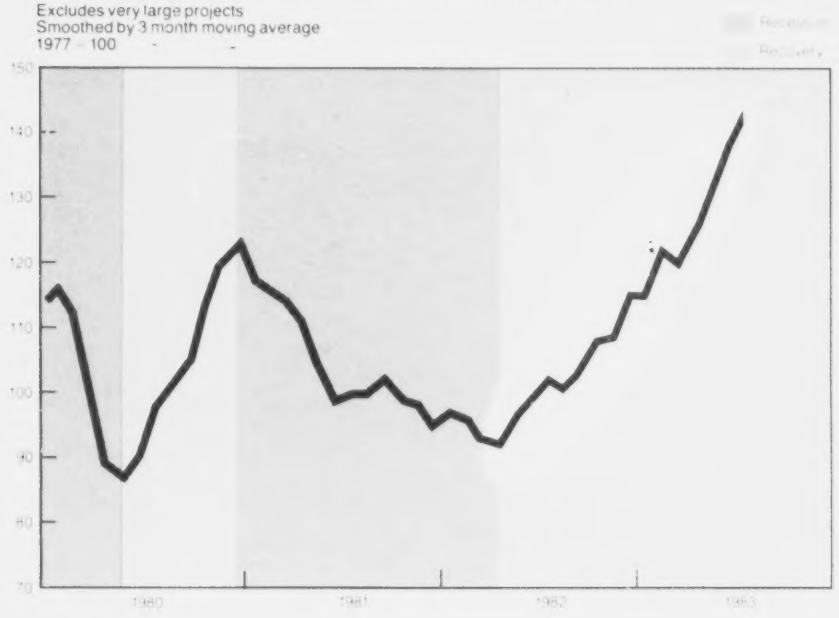
Is 1984 The Year For Nonresidential Building?



Is 1984 The Year For Nonresidential Building?

The Dodge Index of Total Construction Contract Value

Excludes very large projects
Smoothed by 3 month moving average
1977 = 100



So far, the 1980s have brought roughly equal measures of recession and recovery. Like the millionaire who said, "I've been poor and I've been rich, and rich is better," most of us would agree that recovery is a welcome improvement.

For the construction and building materials industries, recovery was ushered in by last year's break in interest rates, which opened the way for a sustained rise in the Dodge Index. The better than 50 percent improvement in this leading indicator of building activity since the spring of 1982 means that $70 billion *more* new construction (at seasonally adjusted annual rate) is now being started than when the recovery first began.

Other measures of market activity confirm the strength of the 1982/83 upswing. At midyear, the value of construction put in place—the measure of work being brought to completion—was 20 percent stronger than it was at the recession's deepest point. Simultaneously, the value of building materials being shipped to the job site also improved by 20 percent. The remaining "gap" between contracting and construction put in place is a gauge of the bright near-term future of the building business. It represents the industry's cushion of "unfilled orders."

As strong as this recovery has been over the past several quarters, it's not everybody's recovery . . . at least not yet. At this point, the expansion of building activity has been a very one-sided affair, with 1983's contracting for residential building leading last year's total by 70 percent at the eight-month mark, while nonresidential building has shown no gain at all. Once again, the market is demonstrating that the building cycle is a sequential process.

We've Been Here Before

Experience tells us what *should* happen next. This is the time for the second stage of expansion to take hold in *non*residential building markets. And that's what the 1984 construction outlook is all about. Will this newest building cycle continue to develop in the time-honored style? Don't bet on it.

During the first year of recovery (mid-1982 through mid-1983), mostly normal and predictable things were happening to housing and public works construction. Homebuilding surged as mortgage rates toppled from their extraordinary peak of 18 percent. Public works spending was stepped up via the 5¢ fuel tax and the Emergency Jobs Act. Recently there have been some faint stirrings in the light commercial building market—the usual side-effect of a sustained pickup of housing.

It all sounds very familiar, but what about some of the not-so-normal features of this newly developing cycle?

- Except for the special case of highways, many other types of publicly financed construction are still wilting under the heat of budgetary restraint.

- Heavy industry is emerging from the recession of the early 1980s into an unfamiliar and highly competitive environment which may require more capital spending . . . or less.

- The office-building market was off on a boom all its own in the early 1980s and now faces the near future with a growing surplus of space.

By the end of 1983, the events that shaped the initial stage of recovery will have run their course. There's little more expansion to be squeezed out of the housing or the public works markets, although a case can be made for holding the gains of the recent past at least through 1984. The recovery of commercial and industrial building has hardly even begun, and the next phase of the construction market's revival is waiting to happen in the nonresidential sector. However, it is *there* that the unexpected may happen. In 1984, as housing plateaus, the year-old recovery will either advance or stall in the markets for commercial and industrial building.

Assume We Must

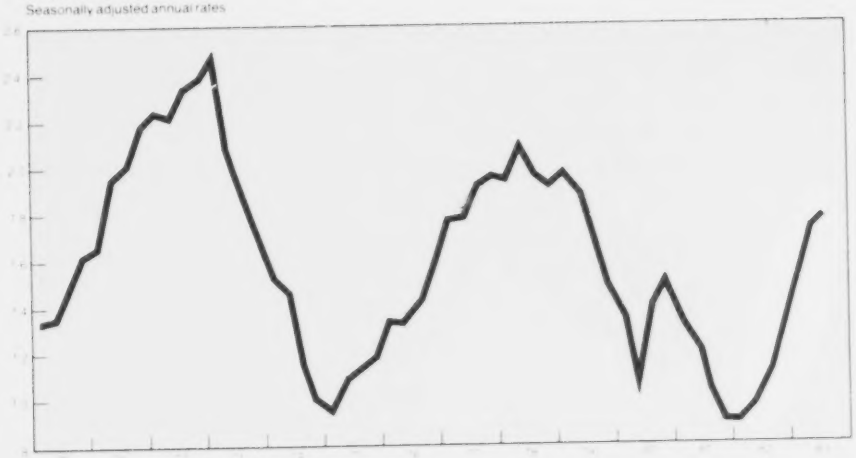
No forecast can be considered properly launched without at least a few basic assumptions. Three very broad ones will do the job.

- The economy's recovery is firmly established, and continued growth through next year will steadily absorb excess capacity and gradually reduce unemployment.

- Inflation will creep up, but only within the range of 4 to 6 percent.

- Long-term interest rates are settling into a period of relative stability, with mortgages holding between 13 and 14 percent.

Fortunately, it isn't necessary to make a guess about the outcome of next November's election. Nevertheless, the mere fact that an election is coming up will influence monetary and fiscal policy in the meantime. For construction markets, it will be a positive influence.



Over the past several quarters, the housing market fulfilled last year's prophecy that a substantial decline in mortgage rates would result in a substantial gain in housing starts. As prophecies go, that was one of the easy ones, but even so, there were a few small surprises in the way it all worked out.

The decline of interest rates was *not* one of them. The Federal Reserve made it happen, and the only element of mystery was how far down rates would go before the Fed brought the process to a halt. For mortgages, the 13-percent floor (down from 18 percent) was quite accurately predicted.

One of the pleasant surprises was the amount of housing demand that 13-percent mortgage money brought forth. Last fall's "consensus" forecast for 1983 was in the range of 1.3 to 1.4 million dwelling units—at that, a solid gain of one-third or more. However, the enthusiastic response of the market led to continuous upgrading of the year's potential, as the forecasting fraternity followed the market up to a total of 1.7 million units. Was this an indication of pent-up demand carried forward from two prior years of extremely low building, or was it a sign that borrowers didn't believe that 1983's "bargain" rates would last very long?

Another interesting aspect of 1983's housing rebound was the mix of one-family and multi-family units. Conventional wisdom has it that falling mortgage rates are supposed to be a boon to home ownership, which ordinarily means one-family houses. And, of course, that did happen. But while it was happening, multi-family building soared 45 percent to a surprising 660,000 units. It meant that condominiums (owner-occupied units which are counted, along with rentals, as multi-family dwellings) were also greatly stimulated by falling mortgage rates in 1983. Considering the cost spread between a 1,300-square-foot condo and a typical 1,600-square-foot single-family house ($15,000?), condos are becoming ever more viable substitutes for traditional one-family homes.

The regional pattern of 1983's housing recovery reflected the general loosening of credit more than it did the differentials in housing demand from one area to another. All four regions surged ahead as mortgage rates fell, with the West leading the others and the North Central trailing moderately.

Now that interest rates have not only stopped falling, but have crept part-way back, the focus turns to questions like, "How long will it be before the next cyclical decline of housing starts sets in?" As long as short-run housing-market behavior continues to be the mirror image of interest rates (and that's almost as dependable as Newton's Third Law of motion), the answer rests, as always, with the money market. If we assume that mortgage money—now back up to 13¾ percent—will remain steady at its current level, then we can expect that 1984's residential building will be at least the equal of 1983's total of 1.7 million units, and maybe a bit more. But stability has not been a characteristic of interest rates in the era of monetarism. What, then, *are* the arguments to support the critical assumption that there will be an adequate supply of mortgage money available in 1984 at the acceptable rate of 13 to 14 percent?

The Federal Reserve has more and better reasons to keep interest rates where they are than to force them up again by squeezing the money supply. The main justification for another round of severe monetary restraint would be to head off a resurgence of inflation, but that just isn't a real concern for the short run. Food prices will probably push up the Consumer Price Index a bit next year, but even so, inflation at 5 percent (vs. 4 percent in 1983) has to be an acceptable alternative to the risk of yet another credit-crunch recession. To support the economy's continued improvement through 1984, monetary policy must be moderately expansive, and the Fed recently prepared the way for this by raising its M targets to 5 to 9 percent.

"Crowding out" isn't a serious threat in 1984. As long as the Fed leans toward the higher end of its monetary growth range, there should be enough credit to meet all the economy's needs—including housing. As the economy's recovery strengthens, business demand for capital must be expected to increase, while Treasury borrowing eases somewhat with rising tax revenue. As this tradeoff in the demand for credit occurs, a record $32 billion of outstanding mortgage commitments by thrift institutions should keep the housing industry going through 1984.

Outlook 1984

Difficult as it is to imagine the normally volatile housing market suspended at any level of output for long, this is the most likely prospect for 1984. Stability is not without precedent, even if it is rare. It

Residential Building Contract Value

Seasonally adjusted annual rates, in billions of dollars

Year/Quarter		Total	One Family	Multi-Family*
1983	I	$ 84.5	$57.4	$27.1
	II	92.8	64.8	28.0
	III	96.5	64.0	32.5
	IV	93.1	63.5	29.6
1984		[illegible]	[illegible]	[illegible]
		[illegible]	[illegible]	[illegible]
		[illegible]	[illegible]	[illegible]
		[illegible]	[illegible]	[illegible]
1983		$ 91.7	$62.4	$29.3
1984		[illegible]	[illegible]	[illegible]
% Change		+10	+15	—

*Includes Nonhousekeeping Residential Buildings

1984 National Estimates Dodge Construction Potentials

Nonresidential Buildings	1983 Preliminary	1984 Forecast	Percent Change 1984/83
Floor Area (millions of square feet)			
Office Buildings	252	182	−28
Stores & Other Commercial	360	427	+19
Manufacturing Buildings	101	128	+27
Total Commercial & Mfg.	713	737	+ 3
Educational	71	67	− 6
Hospital & Health	80	75	− 6
Other Nonresidential Buildings	119	131	+10
Total Institutional & Other	270	273	+ 1
Total Nonresidential Buildings	983	1,010	+ 3
Contract Value (millions of dollars)			
Office Buildings	$18,300	$13,750	−25
Stores & Other Commercial	13,600	16,225	+19
Manufacturing Buildings	5,425	7,400	+36
Total Commercial & Mfg.	$37,325	$37,375	—
Educational	$ 6,075	$ 5,975	− 2
Hospital & Health	8,600	8,750	+ 2
Other Nonresidential Buildings	8,775	9,575	+ 9
Total Institutional & Other	$23,450	$24,300	+ 4
Total Nonresidential Buildings	$60,775	$61,675	+ 1

Residential Buildings	1983 Preliminary	1984 Forecast	Percent Change 1984/83
Dwelling Units (thousands of units*)			
One-Family Houses	1,015	1,100	+ 8
Multifamily Housing	660	625	− 5
*F.W. Dodge basis			
Total Housekeeping Residential	1,675	1,725	+ 3
Floor Area (millions of square feet)			
One-Family Houses	1,580	1,722	+ 9
Multifamily Housing	628	603	− 4
Nonhousekeeping Residential	75	67	−11
Total Residential Buildings	2,283	2,392	+ 5
Contract Value (millions of dollars)			
One-Family Houses	$ 62,450	$ 71,725	+15
Multifamily Housing	23,975	24,250	+ 1
Nonhousekeeping Residential	5,300	5,075	− 4
Total Residential Buildings	$ 91,725	$101,050	+10

Nonbuilding Construction

Contract Value (millions of dollars)			
Highways & Bridges	$ 15,450	$ 16,950	+10
Sewer & Water	7,525	7,400	− 2
Other Public Works	6,750	6,500	− 4
Total Public Works	$ 29,725	$ 30,850	+ 4
Utilities	$ 9,500	$ 11,000	+16
Total Nonbuilding Construction	$ 39,225	$ 41,850	+ 7

All Construction

Contract Value (millions of dollars)			
Total Construction	$191,725	$204,575	+ 7
Dodge Index (1977 = 100)	137	146	

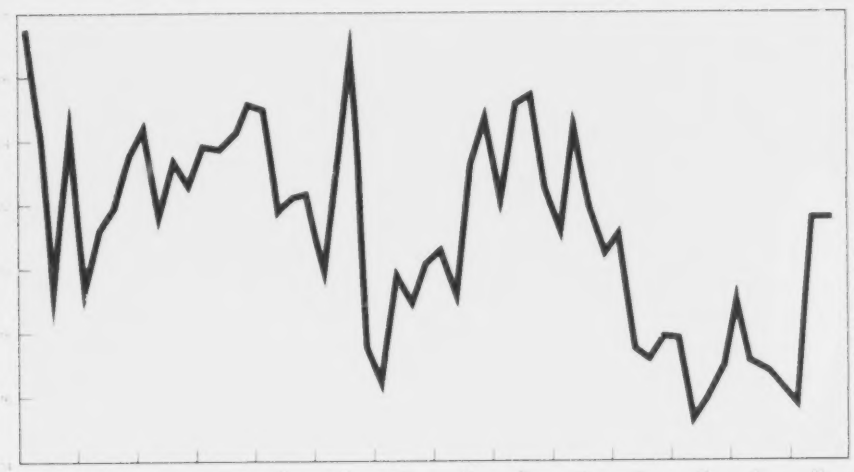
happened as recently as 1981-82 when extremely tight money held housing output to only 1.1 million units for two consecutive years. This time, however, the market will enjoy an extended stay at the upper end of the cycle as a total volume of 1.725 million units (F.W. Dodge basis) is the 1984 forecast.

Residential building contract value, which soared more than 50 percent in 1983 to $91.7 billion, is expected to exceed $100 billion in 1984.

Household formation doesn't usually carry much weight in short-term forecasting, but the demographics of the housing market have been so far off course in the early 1980s that they could influence the market in 1984 and 1985. So far in the decade, household formation has been extremely low, averaging only 1.1 million per year. That contrasts with an annual average of 1.7 million during the 1970s. Temporary conditions, like high unemployment and a restricted supply of shelter, would explain much of the drop, pointing to the likelihood of a considerable amount of "doubling up" (newlyweds living with relatives, for example). That would mean there's a substantial backlog of housing demand—especially for condos and apartments—still to be met as households "undouble" over the next couple of years.

The presence of a backlog of demand (a positive force), along with the probability of gradually rising interest rates over the next few years (negative), sets parameters for the short-term housing outlook. They suggest continued strong short-run conditions, reaching a peak in housing starts toward the end of 1984, followed by a gradual winding down, rather than a steep decline, as has often been the case in the past.

Public Works Construction
Contract Value in Billions of Constant (1977) Dollars
Seasonally adjusted annual rates



Public Works

Two opposing forces are battling for domination of the public works construction market. One, the "New Federalism," involves the systematic transfer of responsibility for construction and maintenance of the nation's highways, bridges, mass transit, water resources, and waste-treatment facilities from the federal government to local governments. The other, which might be called the "old Keynesianism," concerns the use of these same public works programs as a means of stimulating the economy and creating jobs. If the ghost of J.M. Keynes seems to have the upper hand, it has only been very recently—and won't be for long.

Since 1980, the reorientation of public works construction from federal to local governments has had a generally negative outcome, because the Feds were able to withdraw faster than the locals could expand. The 1980s have not been kind to local governments.

Some of the consequences of this one-sided tradeoff: between 1980 and 1982, federal outlays (direct spending plus grants to local governments) through the major public works programs were reduced to approximately 85 percent of the amount authorized by existing legislation. Contracting for public works construction slipped from a peak of $29 billion to $26 billion—a decline of 10 percent, suggesting that local governments were able to share a bit more of the load. But after adjustment for inflation, the hard fact is that in 1982, the combined total of public works construction—measured in *constant* dollars—had shrunk by nearly one-fourth from its peak volume at the end of the 1970s.

Early in 1983, the switch to the traditional use of public works as an anti-recession stimulus reversed that decline abruptly. The passage, in rapid succession, of the Surface Transportation Assistance Act (January) and the Emergency Jobs Appropriations Act (March) cleared the path for additional billions of public works spending in order to help the economy out of its deepest recesssion since the Thirties.

STAA, the bigger of the two new programs, brought instant relief. Its 5¢-per-gallon fuel tax, 80 percent of which is dedicated to highway/bridge construction and 20 percent to mass transit, will generate an estimated $23 billion of construction over the next four years. Its impact in 1983's second quarter was all that could be expected from a seasonally adjusted annual rate of $12 billion in the opening (pre-STAA) quarter; contracting for highways and bridges surged to $16 billion in the second; and that became the point of departure for the next several years.

It is important to appreciate that the new tax has not altered the underlying trend of highway construction. What it has done is create a $4 billion "step" in 1983 which will last four years. Growth—including the "step"—will still be determined by fuel consumption, which is the primary source of revenue for both the basic Highway Trust Fund and its STAA supplement.

The Jobs Act works differently. Instead of bringing "new money" into the construction market, this measure was designed to accelerate the spending of funds already authorized for existing programs in future years. Of the $8.8 billion of additional funds appropriated for "public works," less than half ($4.2 billion) involves construction, and its impact will be hard to identify. At least 32 different types of construction are involved, with Community Development Block Grants getting the biggest share.

If the spirit of this program is carried out, the extra funds allocated to 1983 and 1984 budgets will not be available for use in the later years for which they were originally authorized.

Outlook 1984

The conflicting motives of economic stimulus and budgetary restraint are giving the public works construction market some new twists, but no consistent direction. A few things are clear, however. The decline of the past three years has been reversed by a 15-percent gain in 1983. By far the biggest improvement has been concentrated in transportation facilities, most especially highways and bridges. Because the new programs that are responsible for 1983's turnaround were operational for only part of the past year, 1984 contracting for public works construction is likely to be still higher as they develop their full potential.

As in 1983, roadbuilding will be the source of most of next year's further gain, offsetting continued weakness in waste-water treatment facilities and water-resource projects which rely heavily on federal funding. A net gain of 4 percent in contracting for total public works construction will bring the year's value above $30 billion for the first time, but will probably not quite match next year's mild rate of inflation. To the extent that local governments are required to assume an even larger share of public works expense, the decline of municipal bond rates over the past year should ease some of the burden.

Like housing (although to a lesser degree), public works construction got its big boost in 1983. And, like housing, it

has the potential for still a little more "residual" expansion in 1984, as the forces that led to the past year's turnaround play themselves out. Before long, the outcry for economic stimulus will be drowned out by warnings of renewed inflation, and budgetary restraint will again dominate the public works market.

Utilities

Plagued with too much capacity, the electric-utility industry reduced its contracting for new generating facilities to $9.5 billion in 1983. The year's decline of more than 15 percent reversed a tenuous recovery of electric-utility contracting that had been underway since the post-nuclear era began in 1980.

Ten major projects, located primarily in the South and West, were responsible for most of the 1983 total. However, the past year also brought the "indefinite postponement" of as many other projects, as utilities continued to adjust to a more realistic view of the need for electricity over the next decade.

Although the continued improvement of the economy should strengthen the demand for energy, utility contracting will be showing only a moderate gain in 1984. The multi-billion-dollar bond default by a Northwestern utility, when it cancelled two projects last summer, added an element of financial uncertainty to the industry's underlying problem of excess capacity.

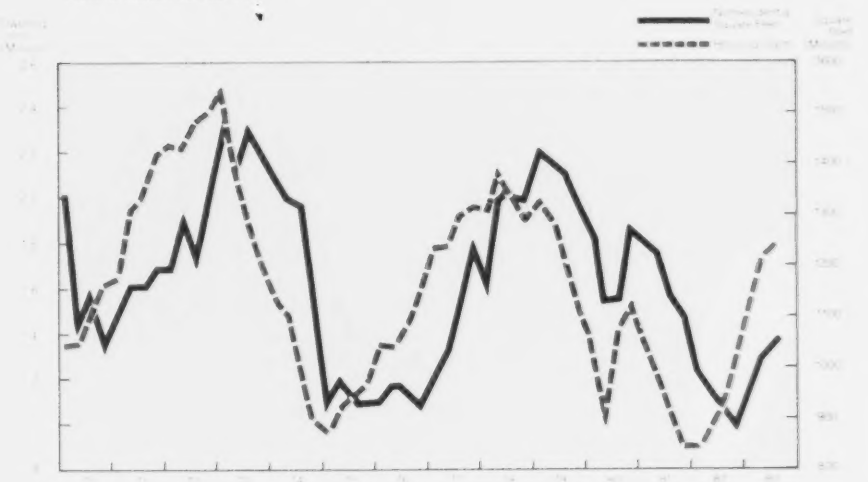
Analysis of 50 projects presently at the planning stage indicates that at least 8, and as many as 10 new power plants are likely to be started in 1984—again mostly in the Sunbelt. The value of next year's contracting for utility projects is estimated at $11.0 billion.

Nonbuilding Construction Contract Value

Seasonally adjusted annual rates, in billions of dollars

Year/Quarter		Total	Public Works	Utilities
1983	I	$31.3	$25.3	$ 6.0
	II	48.3	31.7	16.6
	III	36.3	30.8	5.5
	IV	41.0	31.1	9.9
1984				
1983		$39.2	$29.7	$ 9.5
1984				
% Change		+ 7	+ 4	+16

Nonresidential Building
Millions of square feet
Seasonally adjusted annual rates



There is not much risk that either housing or public works construction will fall back in 1984 from the greatly improved levels they both reached in 1983. But neither is there much opportunity for further expansion in the year ahead. This impasse puts the *non*residential building sector in a crucial role. It is there that the construction industry's year-old recovery will either fizzle or develop its full potential.

The chart above lends a great deal of credibility to the axiom that wherever the construction market is going, housing will get there first. The corollary is, of course, that once housing makes its move, nonresidential building is quick to follow.

Housing leads other forms of building because it is more sensitive to changes in credit conditions and because it requires less start-up time. Nonresidential building lags because its demand is often derived from housing (stores and other light commercial building, for example) and because its typically larger projects require more planning time.

True to form, the peaks and troughs of the housing cycle have been faithfully reproduced in contracting for nonresidential building even through the stress of the past several years: in 1979 (peak), in 1980 (both peak and trough), and again in 1982 (trough). In 1983, a second-quarter upturn of nonresidential building could be the sign that the latest housing recovery has now begun to exert its pull.

Although leads and lags are helpful for gauging the *timing* of building cycles, they don't reveal much about the *strength* of demand. To get at this, it is necessary to probe deeper, examining some of the key categories of nonresidential building individually. Four of them—stores, offices, factories, and "institutional" buildings—deserve special treatment.

At this point in the cycle—the threshold of a broad recovery of nonresidential building—these key categories are pointing in several different directions. Retail building is firmly up. Industrial building appears to be making its turnaround. Office building is still declining. Institutional building seems to be wandering aimlessly. How these individual building markets develop through 1984 will will not only determine the nonresidential building outlook, but will have a considerable bearing on how much the *total* construction market can improve next year.

Retail Building

The unfolding pattern of the housing cycle and, to a lesser degree, the strength of consumer spending will determine the pattern of contracting for stores and warehouses in the quarters ahead.

The recovery of homebuilding, which began in the spring of 1982, was beginning to coax a tenuous response in retail building even before 1983 began. A gain in contracting for stores in 1982's final quarter was the earliest sign of a

turnaround of the three-year-long decline of nonresidential building. At the time, however, this small beginning of recovery was overwhelmed by deepening declines in contracting for offices and industrial construction, which was pulling *total* nonresidential building to its cyclical low point of 896 million square feet.

Steady improvement in contracting for stores and warehouses through the first three quarters of 1983 has brought the retail building market well within reach of this year's estimated total of just under 300 million square feet, an improvement of 23 percent over 1982's exceptionally low volume.

So far, in recovery, contracting for stores and warehouses is showing a reasonably balanced relationship with housing throughout the North Central, the South, and the West, but it seems to be trailing in the Northeast.

Outlook 1984

As housing starts lose their early momentum and level off in the range of 1.70 to 1.75 million units for the next several quarters, there will be a need for some "catching up" to bring retail building into line with this volume of residential building.

Past experience shows that a volume of 1.7 million housing starts s..ould be capable of supporting as much as 400 million square feet of retail building. But it won't all happen in 1984, due to the familiar lag. Allowing for housing's two-quarter head start, 1983's gain of 53 percent converted into a 22 percent advance in contracting for stores and warehouses. In 1984, when the potential for further expansion of homebuilding is limited to only 5 percent or less, retail building will pick up another 20 to 25 percent. Even then—at an estimated 366 million square feet—stores and warehouses will not have reached full potential.

In 1985, a further gain of 10 to 15 percent will be needed to establish "parity" with housing.

Housing and the Retail Building Lag

Year	Dwelling Units (000)		Retail Sq. Ft. (000,000)	
1980	1,331	-25%	378	-26%
1981	1,127	-15%	337	-11%
1982	1,093	- 3%	245	-27%
1983	1,675	+53%	298	+22%
1984	1,725	+ 3%	366	+23%
1985	1,675	- 3%	415	+13%

Manufacturing Building

Now that rising industrial production is beginning to take up the large volume of excess plant capacity that was the legacy of three years of off-and-on recession, the time has come for a welcome recovery of industrial construction.

Since the last peak was reached in 1979, contracting for manufacturing building declined steadily—from 243 million square feet to less than half that volume by 1982. In 1983, the beginning of what may be a different kind of recovery is finally taking hold.

After a decade or more of underinvestment in plant and equipment, American industry finds itself at a distinct disadvantage in world markets. If this economy is to recapture some of its former prominence as an industrial power, a larger share of GNP must be diverted into capital spending. Whether by the indirect route of tax incentives or by the adoption of a more formalized "industrial policy," conditions are favorable for an era of better-than-average industrial development. Only time will tell whether its potential will be realized or other priorities will take precedence.

For the short run, which is of greatest concern here, the signs are good. Recovery of industrial building has begun, and the obsolescence of existing capacity seems to be one motive for a stronger rebound than previous experience would indicate. Although industry is carrying a high percentage of excess capacity into the current recovery, much of it is not *competitive* capacity and may never be reactivated. Perhaps because of this, the current cycle of industrial building is showing more of a "V-shaped" trough and a stronger initial rebound than the long, flat bottom of the mid-1970s' recession.

Outlook 1984

Owing to an extremely weak first quarter of only 88 million square feet, recovery through the balance of 1983 (to 112 million by the final quarter) will leave this year's total at only 101 million square feet (the fourth consecutive annual decline). In 1984, however, when capacity utilization is expected to average close to 80 percent, contracting for industrial construction is estimated to total 128 million square feet, a gain of 27 percent. By 1987, annual volume is expected to exceed 200 million square feet.

One indication of what a long way back it will be for the industrial building market. Next year's forecast gain of 27 percent will still leave the 1984 total *below* the worst year of the mid-1970s' cycle.

Manufacturing Building and Capacity Utilization

Year	Manufacturing Capacity Utilization (%)	Manufacturing Building Sq. Ft. (000,000)
1980	80	215
1981	79	187
1982	71	118
1983	74	101
1984	79	128
1985	81	154

Institutional Building

One of the few construction markets to remain insulated from the business cycle, institutional building marches instead to the demographic drummer. Schools and hospitals, the two most important building types in this group, offer an interesting contrast. By their responses to the changing composition of the nation's population, both building markets are headed toward the common level of 70-80 million square feet annually, but from opposite directions.

- A *shrinking* student population has steadily reduced the demand for educational building from a peak (in the late '60s) of nearly 250 million square feet annually to the current (1983) volume of only 71 million square feet. Significantly, half of all educational building now consists of additions and alterations to existing structures.

- An *expanding* older population (the over-65s are currently increasing twice as fast as the rest of the population) implies an intensified need for hospitals and nursing homes. This highly specialized building market, which only a decade ago was faced with a surplus of facilities, is now at the beginning of a period of renewed growth.

Outlook 1984

In 1984, a slim one percent advance (to 273 million square feet) will help to sustain the newly upward trend of total institutional building, following nearly a decade of steady decline. For most of

1984 Regional Estimates Dodge Construction Potentials

North-east (CT, ME, MA, NH, NJ, NY, PA, RI, VT)	1983 Preliminary	1984 Forecast	Percent Change 1984/83
Contract Value (millions of dollars)			
Nonresidential Buildings			
Commercial and Manufacturing	$ 6,150	$ 5,950	– 3
Institutional and Other	4,050	4,200	+ 4
Total	$10,200	$10,150	—
Residential Buildings			
One-Family Houses	$ 6,875	$ 8,050	+17
Multifamily Housing	3,850	4,225	+10
Nonhousekeeping Residential	1,025	1,125	+10
Total	$11,750	$13,400	+14
Nonbuilding Construction			
Highways and Bridges	$ 2,275	$ 2,650	+16
Other Public Works	2,800	2,675	– 4
Utilities	400	700	+75
Total	$ 5,475	$ 6,025	+10
Total Construction	$27,425	$29,575	+ 8

South (AL, AR, DE, DC, FL, GA, KY, LA, MD, MS, NC, OK, SC, TN, TX, VA, WV)	1983 Preliminary	1984 Forecast	Percent Change 1984/83
Contract Value (millions of dollars)			
Nonresidential Buildings			
Commercial and Manufacturing	$15,025	$14,850	– 1
Institutional and Other	9,050	9,250	+ 2
Total	$24,075	$24,100	—
Residential Buildings			
One-Family Houses	$29,325	$32,900	+12
Multifamily Housing	11,175	10,725	– 4
Nonhousekeeping Residential	2,300	2,175	– 5
Total	$42,800	$45,800	+ 7
Nonbuilding Construction			
Highways and Bridges	$ 5,850	$ 6,400	+ 9
Other Public Works	5,075	5,050	—
Utilities	3,600	4,400	+22
Total	$14,525	$15,850	+ 9
Total Construction	$81,400	$85,750	+ 5

North Central (IL, IN, IA, KS, MI, MN, MO, NE, ND, OH, SD, WI)	1983 Preliminary	1984 Forecast	Percent Change 1984/83
Contract Value (millions of dollars)			
Nonresidential Buildings			
Commercial and Manufacturing	$ 6,875	$ 7,050	+ 3
Institutional and Other	4,375	4,550	+ 4
Total	$11,250	$11,600	+ 3
Residential Buildings			
One-Family Houses	$10,200	$11,725	+15
Multifamily Housing	2,950	3,150	+ 7
Nonhousekeeping Residential	650	600	– 8
Total	$13,800	$15,475	+12
Nonbuilding Construction			
Highways and Bridges	$ 4,300	$ 4,400	+ 2
Other Public Works	3,000	2,775	– 7
Utilities	1,400	1,700	+21
Total	$ 8,700	$ 8,875	+ 2
Total Construction	$33,750	$35,950	+ 7

West (AK, AZ, CA, CO, HI, ID, MT, NV, NM, OR, UT, WA, WY)	1983 Preliminary	1984 Forecast	Percent Change 1984/83
Contract Value (millions of dollars)			
Nonresidential Buildings			
Commercial and Manufacturing	$ 9,275	$ 9,525	+ 3
Institutional and Other	5,975	6,300	+ 5
Total	$15,250	$15,825	+ 4
Residential Buildings			
One-Family Houses	$16,050	$19,050	+19
Multifamily Housing	6,000	6,150	+ 3
Nonhousekeeping Residential	1,325	1,175	–11
Total	$23,375	$26,375	+13
Nonbuilding Construction			
Highways and Bridges	$ 3,025	$ 3,500	+16
Other Public Works	3,400	3,400	—
Utilities	4,100	4,200	+ 2
Total	$10,525	$11,100	+ 5
Total Construction	$49,150	$53,300	+ 8

the 1980s, however, renewed growth of institutional building will remain inhibited by the further decline of educational building. Even as the demographics of the school market begin to turn around as a result of an "echo effect" of the Fifties generation, the need to build new elementary schools will be limited by the vast stock of under-utilized facilities.

Because of diverging trends in the individual categories of institutional building, it will be very late in the decade (1988, perhaps) before annual square footage again reaches 300 million.

Office Buildings

The wind-down from the great office building boom of the early 1980s got off its track in 1983. After reaching a peak of 325 million square feet in 1981, contracting eased to 261 million in 1982—still a very high rate of building. But in 1983, instead of declining further as widely expected, office building held virtually even with 1982's strong volume. That just pushed the inevitable correction for several years' overbuilding another year into the future.

A brief chronology of the events leading to the present imbalance in the office building market points the way to 1984 and 1985:

- White-collar employment rose spectacularly in the late 1970s, reaching a peak gain of 2.2 million in 1979 (vs. 1.5 million per year in the mid-1970s).

- Office building increased sharply in response—from 207 million square feet in 1978 to a record 325 million by 1981.

- By 1981, however, the conditions that led to this building boom had already changed. White-collar labor-force growth was slowing. Recession was driving unemployment up. The office-vacancy rate was beginning to rise.

- In 1982, even though office contracting was cut back 20 percent (to 261 million square feet), vacancies rose sharply as previously started projects were completed and available for occupancy.

- In 1983's first half, a surprising thing happened. Contracting for office space increased again, almost back to the extraordinary 1981 rate of building.

Only one word is needed to describe the office-building market in the fall of 1983: *overbuilt*. A match-up of the cumulative additions to the *supply* of space (square footage of contracting) since the mid-1970s with the cumulative *demand* for it (the net growth of the white-collar workforce) reveals a surplus of nearly a full year's building. The double-digit vacancy rate for offices bears it out.

To make matters worse, the high rate of office starts that has persisted through 1983 is aggravating rather than easing the problem. Analysis indicates that a total of 225 million square feet is the most that can be absorbed in a year by the current rate of growth of the labor force. Any volume of building higher than this (1983's total will be over 250 million) adds still more to the already existing glut of space.

If current labor-force growth cannot support more than 225 million square feet of new construction per year, the existing surplus will be reduced only by adding *less* than 225 million square feet for the next few years. All evidence points to a decline of office building in 1984 (and in 1985 as well). The issue is the market due for a collapse, or a gradual adjustment?

The regional distribution of the surplus of office space adds another necessary dimension to the outlook. With the current excess supply heavily concentrated in a number of major metropolitan areas throughout the South and Southwest (Denver, Dallas, Houston, and San Diego are some of the conspicuous ones), there remains a narrow majority of office building markets (New York and Chicago among them) that still enjoy a reasonable balance of supply and demand. The prospect that a sizeable number of cities can continue to support their normal volume of building during the adjustment period suggests that the correction to the excesses of the early 1980s will take the form of an extended decline rather than a sudden collapse.

High Rise/Low Rise

Percent of Total New Office Square Footage in Buildings With Five or More Stories

Year	Percent	Year	Percent
1970	54	1977	27
1971	50	1978	33
1972	45	1979	36
1973	40	1980	44
1974	33	1981	54
1975	31	1982	48
1976	26	1983(p)	49

Outlook 1984

With the rate of contracting still above 250 million square feet in 1983's third quarter, a pattern consistent with an extended decline might find 1984's contracting beginning at a rate close to 200 million square feet and finishing around 165 million for a total of 182 million square feet (a decline of 30 percent). A further decline—to the range of 125 to 150 million square feet—is indicated for 1985.

Total Nonresidential Building

The 1984 nonresidential building market looks better if it is approached selectively rather than collectively. Next year's recovery will have three unusual features, all due to the distorting influence of the maverick office building cycle.

- As the table below shows, the combined total of all nonresidential building *excluding offices* is headed for a healthy 13 percent gain in square footage in 1984. That's just about on a par with the recovery from the mid-1970s' recession (+14 percent) and a lot stronger than the one before that (+8 percent). But with the inclusion of offices, which will be going the other way in 1984, next year's total nonresidential square-footage gain is reduced to only 3 percent—just about the same nominal increase as for housing.

Nonresidential Building Square Footage

(in millions)

	1983	1984	1984 Gain
Commercial & Industrial (excluding Offices)	461	555	+20%
Institutional	270	273	+ 1%
Total (excluding Offices)	731	828	+13%
Offices	252	182	−28%
Total Nonresidential	983	1,010	+ 3%

- While total nonresidential square footage is expected to increase by a net 3 percent in 1984, contract value of nonresidential building will be virtually unchanged. Although cost pressures are apt to remain low in 1984, this stability does not imply "negative inflation." It is

what happens in the tradeoff of light commercial building (at $40 sq. ft.) against offices (at $75 sq. ft.).

• The counter-cyclical movement of offices is apt to give the nonresidential building cycle a "double bottom." One trough has already occurred, and that was the true cyclical bottom in 1982's fourth quarter at 896 million square feet. The other is likely to appear during 1983: IV and 1984: I, when declines in office building temporarily outweigh gains in other building types. By 1984's second quarter, however, the negative influence of offices will be less pronounced, and recovery will be less inhibited.

Nonresidential Building Contract Value

Year / Quarter	Total	Commercial / Industrial	Institutional
1983 I	$60.2	$37.9	$22.3
II	59.2	35.9	23.3
III	63.8	39.0	24.8
IV	60.0	36.6	23.4
1984			
1983	$60.8	$37.3	$23.5
1984			
% Change	+ 1		+ 4

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Beyond 1984...

All through 1983, the recovery of the construction market has been retracing familiar steps. Early gains in housing and public works are now pointing the way to further expansion into commercial, industrial, and other nonresidential building. It is at this point, however, that the 1983/84 recovery departs from past patterns and begins to develop a style of its own.

• In 1984, the extension of the construction industry's potential into nonresidential building will be hindered by an overbuilt office market which requires a corrective decline in building.

• Beyond 1984, some issues which have been dormant for the past year or two will take on greater importance. One is the uncharacteristically high level of interest rates that prevailed even as recovery began. The other is the almost forgotten (but not gone) federal deficit.

The threat of high interest rates to the construction industry does not need great elaboration. Even if mortgage rates were to hold steady at 13 percent, a part of the housing market's potential would remain disenfranchised. More than that, when rates rise again—as must be expected once the economy begins to heat up—there is precious little room between the present level where rates are barely workable and the point where they become unworkable again.

The infamous $200 billion budget deficit is more complicated, but no less threatening to the future of the construction industry. For the time being, the deficit is both foe and friend: Foe, because the Treasury's huge borrowing requirements to finance it are keeping interest rates from falling to a more reasonable level; friend, because the deficit itself is the source of the considerable fiscal thrust that is driving the economy's recovery. In another year or so, the deficit will begin to take on a decidedly less friendly manner. As the present slack is taken up, the deficit's value as a source of stimulus has to be weighed against its cost as a source of inflation.

To gain control of the deficit before it becomes an engine of inflation requires at some point that taxes be raised and spending restrained. To hope that an expanding economy will somehow generate enough revenue to close the deficit without a tax increase is unrealistic. It won't, and the failure to raise taxes would leave only the alternatives of accepting higher inflation or relying on monetary restraint to keep it in check. The first three grim years of the 1980s are a case study in suppressing inflation with monetary restraint. It hardly needs to be added, except for emphasis, that credit-sensitive industries like construction bear a disproportionate share of the "cure."

Projections of huge budget deficits extending far into the future present some difficult post-election choices. Experience suggests that the resolution of the deficit problem will be a compromise, involving a blend of taxation, inflation, and monetary restraint during the mid-1980s. Clearly, this poses a major risk to the later-stage development of the new building cycle that is still taking form.

For 1984, however, the risks are minimal. During election years, legislators traditionally do not raise taxes, and central bankers usually try to be accommodating. With inflation dormant for the time being, *external* circumstances can be depended upon to be supportive through 1984 as the building cycle begins to include its absent nonresidential sector. The most urgent short-run problem will be the one that has developed within the construction market itself: the unwinding of the office-building boom.

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